

## Delaware Court Says ‘No’ to Claim against CM for Negligent Review of Payment Applications

With the rise of construction management as a distinct discipline, it has now become commonplace to see projects where an owner has retained not only an architect, but also a Construction Manager and other professionals to assist in administering the work. As a result, courts have been forced to answer the question of whether these professionals should be exposed to liability for negligence claims filed by contractors, their sureties, and others with whom they have no contractual relationship. A federal court in Delaware recently addressed this question in *RLI Insurance Company v. Indian River School District*, 2008 WL 2275487 (D. Del. 2008), and held that a contractor’s surety could not recover from either the project’s Construction Manager or architect on its claims that they negligently administered the pre-termination payment process.

### Erosion of the Economic-Loss Rule and the Rise of Third-Party Negligence Claims

At one time, courts had strictly applied a doctrine known as the “economic-loss rule” to bar any tort claims arising out of the performance of a contract in which the plaintiff sought damages for purely economic losses, i.e., losses that do not result from personal injury or property damage. In construction, such purely economic losses might include delay damages, the cost of extra work, or the costs incurred in attempting to comply with defective specifications.

Most states, however, no longer strictly enforce the economic-loss rule. Some jurisdictions have eliminated the rule altogether while others have carved out broad exceptions. One of the most common exceptions involves claims for professional negligence. Under the Restatement of Torts § 522, a professional may be sued for negligent misrepresentation where (1) the professional gave false information to the plaintiff for use in business transactions with third parties; (2) the plaintiff justifiably relied upon the false information; (3) the professional failed to exercise reasonable care in obtaining or relaying the information; and (4) the professional intended for the plaintiff to rely upon the information. In many states, the plaintiff must also show that the professional was in the business of supplying information.

### Indian River Court’s Conclusion: No CM Liability to Surety for Overpayment of Contractor

The dispute in *Indian River* arose after the default termination of a trade contractor on a project in which the owner administered the project through its architect (the designer of record) and its Construction Manager, which provided agency services. Both the Construction Manager and the architect had contracted directly with the School District, and they each were contractually obligated to review the

trade contractors’ monthly payment applications and to certify that payment was due.

Following the termination of the trade contractor, its surety denied coverage based partly upon alleged overpayments made by the owner to the contractor prior to the termination. The surety subsequently brought suit on its overpayment claims, and it included claims against the Construction Manager and architect for negligent misrepresentation. The Construction Manager and architect both argued that the surety’s claims arose from their administration of the construction work, and not because they were in the business of supplying information to the trade contractor. The district court agreed, holding that any information provided by the Construction Manager or the architect in approving payment applications was merely incidental to their management of the project. The court distinguished these ancillary services from those provided by surveyors, financial advisors, title searchers, and other professionals whose “end and aim” is to supply information to their clients. Thus, the district court held that the economic-loss rule barred the surety’s third-party claims for negligent misrepresentation against the Construction Manager and the architect.

Other courts, however, have examined the specific factual circumstances related to the Construction Manager’s role on a project and allowed third-party claims for professional negligence. For example, in a recent West Virginia decision, the court allowed a surety to proceed with a tort claim against a Construction Manager for negligent project supervision on a contract performed by the surety’s principal. *Mid-State Surety Co. v. Thrasher Eng’g*, 2006 WL 1390430 at \*3 (S.D.W.Va. 2006). The court compared the Construction Manager/surety relationship to that of designer/contractor and found that the Construction Manager owed a duty of care to the surety by virtue of its special role in overseeing the project.

### Lessons Learned from Indian River and Thrasher

While many states now allow third-party claims for professional negligence as an exception to the economic-loss rule, a party that sues for negligent administration of the work will likely need to prove that the defendant was either in the business of supplying information or that it performed a special role on the project that gave rise to duties to third-party claimants. Given the uncertainty of the law and the fact-specific nature of the inquiry undertaken by most courts, Construction Managers would be wise to consider the potential rights of third parties (such as sureties) in their administration of the work. [CM](#)

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